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TAGS: ECON EINV ETRD EFIN SR
SUBJECT: SERBIA: PARLIAMENT PASSES 2010 BUDGET IN LINE WITH IMF PLAN

SUMMARY

¶1. (SBU) The Serbian Parliament on December 21 adopted the government's 2010 budget, totaling nearly $11.5 billion in spending. While the 2010 budget is nearly a 7% increase from the 2009 budget in nominal terms, it is to be the start of a multi year budget reform process expected to decrease the public sector's overall share of GDP. The consolidated budget proposes a 4% deficit, which will be funded primarily through external borrowing. The budget is in line with IMF recommendations, which should permit the IMF to soon approve Serbia's second tranche of its Stand By Agreement. While the government heralded the budget passage, the opposition said it was devastating for the economy. Ultimately, the budget was adopted with a narrow majority with all opposition parties abstaining from voting. While the budget is a step forward, Serbia will need to exercise fiscal discipline and hope for an economic recovery in 2010 if it is to stay on target. End Summary.

2010 Budget: Expenditures and Revenues Up

¶2. (U) The Serbian Parliament adopted the 2010 budget and a set of accompanying laws on December 21 by a narrow majority of 127 to 4. (The budget needed support from 126 of the 250 parliamentarians to pass.) The planned budget projects a modest recovery of GDP of +1.5% in 2010 (after a 3% GDP contraction in 2009), inflation at 6%, and current account deficit of 9% of GDP. The budget projects revenues of $9.8 billion, or 6.6% higher in nominal and 0.6% higher in real terms than the government's revenues in 2009. The budget outlines expenditures of $11.4 billion, or 6% higher than 2009 expenditures, but unchanged in real terms. The expected 2010 budget deficit was projected almost equal to the 2009 deficit at $1.6 billion or 3.4% of GDP while the consolidated state deficit (with local government funding included) would reach 4% of GDP. Since the bulk of the deficit will be financed via international borrowing, Serbia's total external debt as a percentage of GDP is expected to increase from 63.6% in 2008, through 71.1% in 2009 to 73.5% in 2011.

Finance Minister: Public Consumption Restrained

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¶3. (U) Finance Minister Dijana Dragutinovic called the budget socially just, stimulative, much closer to international standards and more transparent than previous budgets. At a December 2 press conference Dragutinovic said the government had conservatively projected budget revenues while restraining consumption in 2010 through freezes in public wages and pensions. As a result, the public revenues' share in GDP was projected to decrease from 38.6% in 2009 to 38.3% in 2010 while expenditures' share in GDP would fall from 43.1% to 42.3%. In line with the government's efforts to stimulate the economy, the budget favors capital expenditures. The budget outlines support for economic activity via subsidized loans, direct subsidies, and housing and infrastructure projects, such as the Corridor 10 highway construction.

VAT Major Revenue Source; Pensions, Wages Costly

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¶4. (U) The structure of the 2010 budget revenues remains dominated by VAT (49% of total revenues), excise tax (20%) and personal income tax (12%) while the expenditure side is dominated by transfers to the Pension, Employment and Health fund (34%), wages (24%), social programs (10%), transfers to the other levels of government (8%) and subsidies (6%).

Budget Maintains Ad Hoc Adjustments and High Subsidies

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¶5. (SBU) Despite the government's attempt to reign in expenditures in 2010, pensions and subsidies were expected to be a growing public burden, Milojko Arsic, member of Prime Minister Cvetkovic's economic advisory team, told us on December 15. Transfers to the pension fund were projected to increase 1.4% nominally despite frozen pensions due to the increased number of pensioners. A real increase was projected in subsidies totaling $640 million (mostly to railways and agriculture), interest rates payments (due to increased public debt) and for public procurement. Arsic said the biggest revenue increase was to be an increase on the excise tax for cigarettes. VAT revenues were projected unchanged, while income and corporate taxes and customs were projected to drop in real terms due to the poor economy and decreased customs rates with the EU. Arsic's major complaint about the budget was that major adjustments were done via ad hoc measures (freeze of wages and pensions), raising doubts about their long-term sustainability.

Independent Institutions Receive Requested Amounts

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¶6. (U) For the first time the Government fulfilled its obligation toward funding independent state institutions - the newly formed Anticorruption Agency, State Auditing Institution, Trustee for Information of Public Interest, Ombudsman - and approved in the budget the exact amounts they requested. Some analysts claimed this was a result of public pressure and an EU request.

Opposition: Budget Devastating for the Economy

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¶7. (U) During the week long budget debate, the opposition parties claimed the budget would be disastrous for the economy. Overall, the parliament adopted only 13 of the 240 budget amendments submitted by the opposition. Nenad Popovic from the opposition Democratic Party of Serbia (DSS) said that the budget was "devastating" due to the $547 million deficit increase over the April 2009 budget rebalance, which he said would put a huge additional burden on the economy. Jorgovanka Tabakovic from the Serbian Progressive Party (SNS) complained that the budget was a government attempt to exert its economic influence and to minimize the role of the parliament. The SNS had submitted amendments seeking more money for defense and subsidies in agriculture. The Radical Party (SRS) unsuccessfully sought to decrease funds for Serbia's EU integration efforts and to increase funding for cooperation with non-aligned countries.

Budget Passes with Slim Majority

¶8. (U) The budget was adopted with a narrow majority of 127 out of 250 MPs. The budget was supported by 124 MPs from the ruling coalition, plus two independent MPs and the parliament's sole ethnic Albanian MP. Four governing coalition MPs from the Alliance of Vojvodina Hungarians (SVM) voted against the budget, claiming the budget was not in line with the Serbian Constitution, and that Vojvodina was receiving an insufficient share of government revenues allocated for capital investments. Balint Pastor from SVM claimed on December 12 that out of $837 million allocated for Vojvodina, the effective budget (when public sector wages and old debts are excluded) was only $187 million and that Vojvodina would go bankrupt. SVM had also made it difficult for the government to adopt the 2009 budget rebalance in April 2009. Coalition members, including both the DS and smaller parties such as League of

Vojvodina Social Democrats, criticized SVM for not supporting the government and hinted that the coalition might be reevaluated. There are now rumors that DS could remove SVM from the coalitions in the Vojvodina Assembly and the Subotica city assembly, where DS has absolute majorities.

Liberals Request Pensions to be Decreased

¶9. (U) The Liberal Democratic Party (LDP) also chose not to support the budget due to large transfers to the pension fund. LDP leader Cedomir Jovanovic criticized the $270 million per month transfers to the pension fund, noting many pensioners were opposed to EU and NATO integration, which LDP supported. Jovanovic claimed the budget was the victim of numerous political deals and said the government had not made an inter-generation agreement but instead chose to "give welfare to pensioners by taking away the younger generation's future." Jovanovic asked that pensions be reduced for pensioners who did not serve until full working age. LDP had submitted amendments to decrease subsidies to railways and to allocate more funds for education, science, agriculture and the State Auditing Institution.

Budget Meets IMF Recommendations, But More Reforms Expected

¶10. (SBU) The IMF Resident Representative Bogdan Lissovolik told us on December 15 that the 2010 budget was in line with IMF expectations and agreements (ref A). The IMF Executive Board should now approve the second tranche of Serbia's $4 billion Stand By Agreement later this week. The IMF still expects Serbia to adopt a Law on Pension System Reform by the end of February 2010, cut state administration by 10% in 2010, work on tax reform, and establish better control over public companies, Bogdanovic said.

Comment

¶11. (SBU) Serbia's 2010 budget is a small step in the right direction of public sector reform. While the budget is an important piece of the puzzle and meets the IMF conditions, Serbia must incorporate greater structural reforms to bring pensions, subsidies and state spending under control. The budget's narrow passage in parliament and the opposition's vocal distrust of the government's reform efforts proves that this will be a difficult task in the months to come. There could be political fallout from SVM's unwillingness to support the budget. While it is unlikely that DS would endanger the national coalition, some response in Vojvodina is likely forthcoming. End Comment.
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